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In the Supreme Court of the United States

THE MEADWESTVACO CORPORATION, SUCCESSOR IN INTEREST TO THE MEAD CORPORATION, PETITIONER,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS, RESPONDENTS.

On Writ of Certiorari to the Appellate Court of Illinois

BRIEF FOR RESPONDENTS

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QUESTION PRESENTED

Whether Mead proved by clear and cogent evidence that the Constitution prohibits Illinois from taxing a fraction of the billion-dollar gain that Mead realized from the sale of Lexis/Nexis, its electronic publishing division, a business that Mead actively conducted in Illinois for nearly two decades.

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BRIEF FOR RESPONDENTS

STATEMENT

The Relationship between Mead and Lexis/Nexis

1. Mead supported Lexis/Nexis for years before it became profitable.

Mead (now "Meadwestvaco") Corporation ("Mead"), an Ohio domiciliary and Illinois taxpayer, purchased Data Corporation in 1968 for approximately $6 million. J.A. 9, 152-53. Although Mead was interested in Data Corporation primarily for its ink jet printing technology, which potentially related to Mead's paper and office supplies business, J.A. 152, Data Corporation's products also included a full-text information retrieval technology originally developed for the United States Air Force. J.A. 152-53.

Shortly after acquiring Data Corporation, Mead transferred its information retrieval line to a wholly owned subsidiary called Mead Data Central ("MDC"). J.A. 9. Working with the Ohio and Missouri Bar Associations, MDC transformed this product into a computer-assisted legal research service, which MDC launched in 1973 as Lexis. J.A. 153.[1]

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[1] In addition to Lexis, MDC also came to include Nexis, a computer-assisted news, financial, marketing, and general information retrieval service, as well as several other businesses. J.A. 99-100. Although Mead never formally changed MDC's name, MDC was referred to as "Lexis/Nexis" during the proceedings

Lexis/Nexis was not immediately successful, J.A. 154, and did not become profitable until the late 1970s, J.A. 154-55. Prior to that time, Mead kept Lexis/Nexis afloat with capital contributions. J.A. 169. Lexis/Nexis came to do substantial business in Illinois, and it headquartered its Lexis Document Services in Springfield. J.A. 14, 104.

2. Mead supported Lexis/Nexis financially and oversaw critical decision-making.

Even after Lexis/Nexis became profitable, Mead continued to provide needed operating resources and to take an active role in its economic decision-making. The record includes numerous examples. In 1984, Mead's Corporate Objectives Committee ("Committee"), having been "impressed with the growth and general development of [Lexis/Nexis] and its strong position in the electronic publishing field," concluded that its "sale or other disposition * * * should not be pursued." J.A. 132. Instead, the Committee "encouraged [Lexis/Nexis] management to continue to develop growth plans for this division, including potential acquisitions, and requested that each such acquisition be presented to the Committee for its consideration." *Id.* Shortly thereafter, Mead's Board of Directors ("Board") approved a request by Lexis/Nexis to undertake two significant capital projects. The first was to acquire additional central processing units, at a cost of up to $7.67 million, with Mead itself entering into a lease agreement to procure the units "for use at Mead Data Central division"; the second was to spend

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below. For consistency, respondents use that designation.

$1.65 million to expand Lexis/Nexis's computer center. J.A. 132-33.

Other examples of Mead's support for Lexis/Nexis and close involvement in its management abound. In 1993, Mead's Board approved a $12.9 million expansion of the computer and data storage capacity for Lexis/Nexis's "'Freestyle' search system." J.A. 135. The following year, the Board approved an additional $9.1 million to further increase Lexis/Nexis's computer capacity. J.A. 137. At the same time, Mead authorized Lexis/Nexis to enter into a partnership with American Lawyer Media to create an online communication and conferencing system for lawyers, J.A. 137-38, and allowed Lexis/Nexis to contribute up to $10 million to the new partnership, J.A. 138. Also in 1994, Mead's Board authorized Mead to enter into an agreement with Dow Jones & Company for Lexis/Nexis to distribute certain Dow Jones publications, and formed a committee to approve any distribution agreement. J.A. 141. Finally, that same year, Mead's Board decided to authorize Lexis/Nexis's acquisition of Journal Graphics, Inc. for $6 million, which required Mead itself to pay $200,000 for a related, "standstill agreement." J.A. 144.

3. Mead repeatedly restructured Lexis/Nexis for Mead's tax advantage.

Mead manipulated Lexis/Nexis's corporate form for Mead's own benefit, alternatively treating Lexis/Nexis as a division and a subsidiary, always to collect significant tax savings for Mead. J.A. 14; see also Record Vol. 7, C1741-49. In 1980, for example, Lexis/Nexis, which had been operating as a wholly

owned subsidiary of Mead, was merged into and operated as a Mead division to achieve "projected combined net state income tax savings of $3.0 to $5.0 million over the next five years." J.A. 130-31, 149-50. These tax benefits were available because Lexis/Nexis was not as profitable as Mead at the time, and by treating Lexis/Nexis as a division, Mead could consolidate its own financial results with Lexis/Nexis's for state income tax purposes. J.A. 149.

In 1985, Lexis/Nexis was reincorporated separately for "strategic and tax purposes." J.A. 147. In December 1993, it was merged with Mead again, this time to obtain "substantial state tax savings" estimated to reach "$1.2 million for 1994" and to increase to "$2.5 million [per year] by 2007." J.A. 134, 147. The merger allowed Mead to take advantage of Lexis/Nexis's net operating loss carryforwards. *Id.*[2] Mead paid $350,000 of its own funds to effect this merger. J.A. 134, 147.

4. Mead treated Lexis/Nexis as part of Mead's unitary business for Illinois tax purposes.

Although Mead and Lexis/Nexis filed separate Illinois tax returns for 1988, a Department audit determined that Mead and Lexis/Nexis were unitary businesses. J.A. 13. Mead objected, but to settle the dispute it agreed to treat Lexis/Nexis as part of its unitary business group and to include it in its Illinois

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[2] Net loss carryforwards are tax deductions for losses incurred in one period that may be applied to a later period. See 26 U.S.C. § 172; see also Black's Law Dictionary 227 (West 8th ed. 2004).

combined unitary income tax return, which it did until it sold Lexis/Nexis in 1994. J.A.13; Record Vol. 4, C857-58; Vol. 5, C1105-06, C1120.

Mead's tax returns also show that the Lexis/Nexis publishing division contributed significantly to Mead's overall income. On its 1994 Illinois combined unitary return, Mead reported combined Illinois sales of approximately $338 million, which included nearly $47 million in sales (and property and payroll in excess of $13 million) attributable to the electronic publishing division. Record Vol. 4, C895-96. In fact, of the approximately $3.8 billion in Illinois income that Mead reported between 1988 and 1993, more than $800 million came from Lexis/Nexis. J.A. 14. During these years, Mead also reported approximately $4.5 billion in business expense deductions, more than $680 million of which were attributable to Lexis/Nexis. *Id.*

5. Mead characterized Lexis/Nexis as a business segment rather than an investment.

Throughout this time, Mead consistently described its Lexis/Nexis electronic publishing division as a "business segment," rather than an "investee." In its 1993 annual report, Mead touted itself as a manufacturer and distributor of paper, packaging, and office supplies, as well as "the developer of the world's leading electronic information retrieval services for law, patents, accounting, finance, news and business information." J.A. 59.

In the same annual report, rather than classify the Lexis/Nexis electronic publishing division as an investment, Mead described it as a business segment.

J.A. 80-81. Moreover, Mead cited successes at Lexis/Nexis as examples of Mead's own progress under its "three key initiatives" program, which focused on improving customer satisfaction, productivity, and management performance. J.A. 60-61.

Also in the 1993 annual report, Mead stated that, as part of its effort to improve performance, it had "reorganized its corporate functions," including reallocating certain expenditures among its "operating units." J.A. 85. As a result, Mead reallocated earnings among its "[i]ndustry segments," which by Mead's own description included not only paper, packaging, and office supplies, but also "[e]lectronic [p]ublishing." J.A. 85-86.

Mead likewise described itself as "engaged in the electronic publishing business" in the form 10-K it filed with the Securities and Exchange Commission in 1994, J.A. 92-93, and listed "electronic publishing" as one of its business "[s]egment[s]" rather than as an "[i]nvestee[]," J.A. 93, 99-100, 121-22. Mead also included Lexis/Nexis in its review of its business operations, J.A. 106, 107-08, 120-21, and listed "LEXIS," "Lexpat," and "NEXIS" as trademarks under which Mead "conducts its business" and that are "of material importance to Mead's business," J.A. 102.

6. Mead's dealings with Lexis/Nexis demonstrate a sharing of values.

Mead ran all of its operations, including its electronic publishing division, in a decentralized fashion, Record Vol. 9, RP 109, 111-12, and Lexis/Nexis was subject to Mead's corporate policy requiring sales

between its business segments to occur at substantially the same prices and on substantially the same terms as sales to third-parties, J.A. 127, 163-64.

That being said, Mead reviewed Lexis/Nexis's business plan each year. J.A. 163. Mead also performed a nightly cash sweep of Lexis/Nexis's bank accounts, and managed the money for Lexis/Nexis's benefit "according to whatever investments Mead decided." J.A. 180-81. Mead's witnesses conceded that Lexis/Nexis executives could have invested the company's excess cash themselves, but they chose not to set up "the extensive banking relationships" necessary to do so and to rely instead on Mead's investment decisions. J.A. 180-81. And although a Mead witness stated that there was little sharing of personnel, Record Vol. 9, RP 102, each of the three executives who testified at trial had worked for both Mead and Lexis/Nexis at various points in his career. Record Vol. 9, RP 65-66, 94-96, 114-15. Finally, Mead made Lexis/Nexis part of the "three key initiatives" program, in which Lexis/Nexis enjoyed considerable success. In its 1993 annual report, Mead used Nexis as an illustration of *Mead* having "made an outstanding leap forward" in obtaining customer satisfaction. J.A. 61. Similarly, Mead boasted of Lexis/Nexis's new London processing facility, as well as its newly added search systems and international databases, as examples of the initiatives' success. J.A. 61-63. Mead also highlighted Lexis/Nexis's innovations in modifying search vehicles as emblematic of Mead's new corporate focus on customer satisfaction and "shared values." J.A. 63; Record Vol. 5, C1232.

7. After 26 years in the electronic publishing business, Mead sold Lexis/Nexis in 1994.

In 1994, after studying the "strategic and financial alternatives" for Lexis/Nexis, J.A. 139, Mead's Board decided to sell its electronic publishing division, J.A. 142-43. This plan engendered "considerable discussion" among Board members. J.A. 143. Indeed, for Steve Mason, Mead's chairman and chief executive officer, the decision to sell Lexis/Nexis was "probably the toughest decision I've ever had to make," for Lexis/Nexis was one of Mead's "two very good businesses." J.A. 44. As Mason explained, the decision to sell was particularly "difficult" because Mead had "grown" Lexis/Nexis "since 1968 from a small legal database into the word's premier provider of online legal information and the pioneer in computer-assisted news retrieval." J.A. 33. In deciding to sell Lexis/Nexis, Mead's Board also approved modifications to Mead compensation programs affecting Lexis/Nexis employees, and awarded performance bonuses to certain Lexis/Nexis employees. J.A. 146.

Mead's decision to sell Lexis/Nexis came as a surprise to some industry analysts, who saw Mead as the company that "pioneered the computer information and news retrieval service." J.A. 50. Moreover, Mead had "always done a lot of fixing of its [electronic publishing] product," which remained one of Mead's "growth industries." *Id.* But Mead found "a lot of market interest" in Lexis/Nexis and, in December 1994, sold the electronic publishing division for $1.5 billion. J.A. 87-88. Mead used the proceeds from the sale to buy back stock and retire Mead debt, reducing Mead's vulnerability to a takeover. J.A. 15, 87-88.

Proceedings Below

1. Mead did not report the gain from the sale of Lexis/Nexis as taxable income in Illinois.

On Mead's 1994 Illinois combined unitary return, which a Mead director signed "[u]nder penalt[y] of perjury," Mead treated Lexis/Nexis's ordinary income from that year as apportionable business income, Record Vol. 4, C850—meaning Illinois could tax a share of it.[3] However, although Mead realized a $1.05 billion gain from the sale of its electronic publishing business, Mead claimed that this income, most of it attributed to "goodwill," was nonapportionable nonbusiness income and therefore not subject to Illinois tax. J.A. 5, 8, 53, 55.

After an audit, the Illinois Department of Revenue ("Department") concluded that Mead's gain from the sale of Lexis/Nexis was apportionable business income,

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[3] Illinois law distinguishes between apportionable, "business income" and nonapportionable, "nonbusiness income." 35 ILCS 5/303, 5/304 (2006). In 1994, Illinois law defined "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business," which "include[d] income from tangible and intangible property if the acquisition, management, and disposition of the property constitute[d] integral parts of the taxpayer's regular trade or business operations." 35 ILCS 5/1501(a)(1) (1994). This tracked the definition of business income in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). See *Texaco-Cities Serv. Pipeline Co. v. McGaw*, 695 N.E.2d 481, 484 (Ill. 1998). In 2003, Illinois amended its law to encompass all income that is constitutionally apportionable. See 35 ILCS 5/1501(a)(1) (2006). The 2003 amendment did not, as Mead implies, see Pet. Br. 5 n.1, narrow Illinois's definition of business income.

and that at least a small part of it should have been included in Mead's Illinois taxable income. J.A. 5-6, 26, 55; Record Vol. 9, RP 228. As the Department explained, "[s]ince all aspects of a business contribute[] to its goodwill," some "portion of the gain of goodwill * * * would be attributable to Illinois." J.A. 55.

In determining how much of the gain was subject to Illinois tax, the Department applied Illinois's version of the long-accepted, multi-factor apportionment formula. See *Barclay Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 304 (1994). Under this formula, as Illinois employed it in 1994, the portion of a multistate corporation's business income that is subject to Illinois tax is determined by averaging three "factors": the corporation's Illinois property as a fraction of all of its property; the corporation's Illinois payroll as a fraction of all of its payroll; and the corporation's Illinois sales as a fraction of all of its sales. See 35 ILCS 5/304(a) (1994). These factors are calculated in fractions or percentages, and are themselves averaged (with the sales factor double weighted) to produce a single fraction reflecting the share of the taxpayer's business that occurred in Illinois. See *id.*[4]

In apportioning the gain from the Lexis/Nexis sale, the Department included the approximately $1.05 billion gain in Mead's sales factor denominator (as part of Mead's total sales) but included only about $40.6 million of it (approximately 3.7% of the total gain) in

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[4] In 1999, Illinois began moving to a single-factor apportionment method based solely on sales. See 35 ILCS 5/304(h) (2006).

Mead's sales factor numerator (representing the portion of Mead's sales that occurred in Illinois). J.A. 189. The $40.6 million was calculated using only *Lexis/Nexis's* payroll and sales factors, in an effort to capture only the portion of the total goodwill that was fairly attributable to Lexis/Nexis's activity in Illinois. J.A. 55, 186, 189. This figure was included in the sales factor numerator along with Mead's other Illinois receipts, and the gain was then apportioned using Mead's property, payroll, and sales factors, which averaged about 4.1% of Mead's overall business activity, J.A. 28, 55, nearly identical to the average generated using Lexis/Nexis's factors alone. That ratio then was multiplied by Mead's taxable income, which included the Lexis/Nexis gain. J.A. 28. Partly as a result of this additional income apportioned to Illinois, the Department issued two notices of deficiency for additional tax and interest. J.A. 22-31.[5]

2. The Illinois courts upheld the Department's determination that Illinois may tax a fraction of Mead's gain from the sale of Lexis/Nexis.

Mead challenged the deficiency notices in the Illinois courts, where a trial was held on stipulated

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[5] The two notices included some offsetting items, but the resulting total deficiency was $3,149,222 in tax and $1,049,017 in interest. J.A. 6. Although not clearly reflected in the record, most of Mead's increased tax liability was due to the inclusion of the gain from the sale of Lexis/Nexis in Mead's Illinois apportionable tax base. The remaining significant portion of the deficiency arose from a state law issue resolved in the Department's favor, Pet. App. 18a-22a, and that issue is not before the Court.

facts, exhibits, and testimony.[6] Mead argued that the Federal Constitution did not permit Illinois to tax any of the gain Mead realized from the sale of Lexis/Nexis because, according to Mead, Lexis/Nexis had no connection with the paper, packaging, and office supply business that Mead admittedly operated in Illinois. Record Vol. 8, C1786-95. Mead also claimed that by apportioning a part of the gain to Illinois, the Department had unconstitutionally distorted the share of Mead's income attributable to Illinois. Record Vol. 8, C1795-96.

For its part, the Department argued that the approximately 4% of the $1.05 billion gain that it had attributed to Illinois was properly apportionable under any one of three related theories: (1) the electronic publishing business (Lexis/Nexis) was one of the businesses that Mead conducted in Illinois; (2) Mead and Lexis/Nexis were part of a "unitary" multistate enterprise; and (3) Lexis/Nexis was an operational asset of Mead. Pet. App. 35a-40a; Record Vol. 8, C1841-42, C1847-54. As the Department explained, for any or all of these reasons, there was a sufficient nexus between the Lexis/Nexis division and Illinois to subject a part of the gain to Illinois tax. Record Vol. 8, C1841-42, C1847-54. In addition, the Department indicated that it had isolated the Lexis/Nexis assets located in Illinois and had apportioned to Illinois only the

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[6] Mead's complaint named the Illinois State Treasurer ("Treasurer"), as well as the Department. Under Illinois law, the Treasurer is responsible for maintaining the protest fund into which Mead paid the disputed amounts. See 30 ILCS 230/1 – 230/2a.1 (2006). None of the arguments here relate to the Treasurer's role in this case.

goodwill associated with those Illinois assets, to ensure that no out-of-state value was taxed. *Id.* at C1847.

The trial court found that "at all relevant times" Mead was "involved in the electronic publishing business" through its "business operations" in Lexis/Nexis, Pet. App. 36a-37a, and that "[t]he sale of Lexis/Nexis included assets which were situated in Illinois and used in the production of income reported to Illinois." *Id.* at 37a. Ultimately, the court determined that Lexis/Nexis served "an operational purpose" for Mead. *Id.* at 38a. This was because "Lexis/Nexis represented a significant business segment of Mead," meaning "Lexis/Nexis was considered in the strategic planning of Mead, particularly the allocation of resources." *Id.* "The operational purpose allowed Mead to limit the growth of Lexis/Nexis, if only to limit its ability to expand or to contract through [Mead's] control of its capital investment." *Id.* at 38a-39a. Based on these findings, the trial court determined that although Mead and its electronic publishing business were not a "unitary" business, the Department had properly concluded that a fraction of the gain Mead realized in selling Lexis/Nexis was constitutionally apportionable business income subject to Illinois tax. *Id.* at 39a-40a.

The Illinois Appellate Court affirmed, upholding the lower court's determination that Lexis/Nexis served an operational function for Mead, because Lexis/Nexis had the requisite constitutional nexis with Illinois. Pet. App. 11a. Specifically, the appellate court held that Mead failed to meet its burden of proving that the trial court's finding of operational

purpose was against the manifest weight of the evidence. *Id.* at 14a. The appellate court reasoned that the operational purpose finding was more than adequately supported by the undisputed evidence that Mead was the 100% owner of Lexis/Nexis and was far more than a passive investor. *Id.* at 12a-13a. Mead had contributed capital to Lexis/Nexis, approved major expenditures, manipulated Lexis/Nexis's corporate structure, retained its tax benefits, and exercised control over Lexis/Nexis's excess cash. *Id.* at 13a. In addition, Mead's annual report and SEC filing demonstrated that Mead considered itself to be in the electronic publishing business, and viewed Lexis/Nexis as a business segment rather than an investee. *Id.* Because it determined that Lexis/Nexis served an operational function, the appellate court expressly declined to address the Department's argument that Mead and Lexis/Nexis were also unitary businesses, an alternative basis to uphold the Department's tax. *Id.* at 11a.

Finally, the appellate court noted that although Mead had argued that the Department's inclusion in Mead's Illinois tax base of a part of the gain from its sale of Lexis/Nexis had resulted in an unconstitutionally "disproportionate" share of Mead's income being apportioned to Illinois, Mead never petitioned the Department for alternative apportionment, as Illinois law permits. Pet. App. 17a (citing 35 ILCS 5/304(f) (2004)).

The Illinois Supreme Court denied Mead's petition for leave to appeal from the decision of the appellate

court. Pet. App. 41a. This Court granted Mead's certiorari petition.

SUMMARY OF ARGUMENT

Mead's view that the Constitution does not permit Illinois to tax even a fraction of the $1.05-billion gain Mead realized from the sale of Lexis/Nexis, the electronic publishing division Mead operated in Illinois, is incorrect. The Due Process and Commerce Clauses permit a State to tax income arising from business activity within its borders. In this way, a State may seek a return on "opportunities which it has given, * * * protection which it has afforded, [and] benefits which it has conferred" upon in-state commercial activity. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1941).

The tax at issue here was proper for any one of several, independent reasons. First, it is well settled that an out-of-state company is subject to tax in any State in which the company does business. Mead itself actively conducted an electronic publishing business in Illinois (and elsewhere) through Lexis/Nexis. Not only did Lexis/Nexis carry on substantial business and maintain a physical presence in Illinois, but Mead controlled Lexis/Nexis in myriad ways. Mead was, in its own words, "engaged in the electronic publishing business," J.A. 59, and because that business was conducted in Illinois, Illinois was entitled to tax its fair share of any income it accrued.

Second, Mead and Lexis/Nexis functioned as a unitary business or, at the very least, Lexis/Nexis was an operational asset of Mead. On the former point,

because Mead provided capital support and investment oversight to Lexis/Nexis, managed Lexis/Nexis's more significant expenditures, infused Lexis/Nexis with its management principles, held itself out to the world as a leader in electronic publishing, and even included Lexis/Nexis on its unitary tax returns, decisions of this Court require a finding of a unitary relationship here.

Moreover, even in the absence of business unity, the record amply supports a finding that Lexis/Nexis was an operational asset of Mead. In addition to the facts discussed above, Mead also regularly manipulated Lexis/Nexis's corporate form to appropriate its loss carryforwards as valuable tax savings. This is no different from purchasing paper or other products from Lexis/Nexis at below-market rates, precisely the type of activity this Court has recognized as satisfying the operational function test.

Mead seeks to avoid this result by arguing that the operational function test is but a "narrow exception" to the unitary business principle and that any fact tending to show a unitary business is immaterial to the operational function analysis. But *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992), makes clear that the operational function test is not limited to the one or two illustrations provided therein, and, moreover, that the unitary business and operational function doctrines are not mutually exclusive. Thus, it is perfectly proper to support an operational function finding with facts that would also tend to show a unitary business.

Mead also attempts to avoid any tax by arguing that Lexis/Nexis was nothing more than a "passive investment," but this is flatly belied by the record. To be sure, Mead conducted all of its businesses in a decentralized fashion, and Lexis/Nexis was no exception. But the depth of Mead's involvement in Lexis/Nexis—managing it, manipulating it, and the very public marketing of it—are all characteristic of conducting a business and not simply investing in one.

In any event, even if Mead were merely a passive investor in Lexis/Nexis, Illinois's tax would not run afoul of the Constitution. To the contrary, a State may tax the income an out-of-state corporation derives even from its investment in another out-of-state corporation, so long as the tax fairly reflects the portion of the income that the latter generated within the taxing State's borders. Here, by including only about $40.6 million of the $1.05 billion gain to Mead in the apportionments factors, Illinois properly sought to tax no more than the portion of the gain that was attributable to Illinois.

Indeed, contrary to Mead's claim, sustaining Illinois's tax here raises no threat of prohibited multiple taxation. Mead never presented any evidence that multiple taxation will occur if this tax is upheld. Moreover, in *Mobil Oil Co. v. Comm'r of Taxes*, 445 U.S. 425 (1980), this Court squarely held that the risk of multiple taxation under circumstances analogous to these does not violate the Constitution because the constitutionality of one State's tax should not depend on the vagaries of another State's tax policy.

ARGUMENT

I. A State May Tax A Business With Which It Has The Minimum Constitutional Nexus.

Mead's challenge turns on a single question: Does Lexis/Nexis have the minimum ties to Illinois needed to subject a fraction of the gain realized upon its sale to Illinois tax (any fraction, for Mead does not protest the portion of the Lexis/Nexis gain that Illinois taxed, but the fact that Illinois taxed that gain at all). The Due Process and Commerce Clauses each require "some minimum connection" between a State and the activity it taxes. *Allied-Signal,* 504 U.S. at 777 (internal quotation marks omitted); see also *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165-66 (1983).

This "minimum connection" requirement allows States to tax entities that derive some benefit from a State's law, infrastructure, or citizenry. The bedrock constitutional principle is that "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *J.C. Penney*, 311 U.S. at 444. The ultimate "inquiry in a case such as this, therefore, is whether the taxing power exerted by the state bears fiscal relation to the protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S.

307, 315 (1982) (internal quotation marks omitted); see also *Allied-Signal*, 504 U.S. at 778 ("We are guided by the basic principle that the State's power to tax an individual's or corporation's activities is justified by the protection, opportunities and benefits the State confers on those activities") (internal quotation marks omitted); *J.C. Penney*, 311 U.S. at 442 (State may charge a "price for the privileges it afford[s] foreign corporations within its borders").

A tax on a nondomiciliary company may satisfy this ultimate constitutional requirement in any one of several ways. Most obviously, an out-of-state company is subject to tax in any State in which it actually conducts business. See, *e.g.*, *J.C. Penney*, 311 U.S. at 441 (recognizing established principle that a "state has, of course, power to impose a tax" on "corporations chartered by other states but permitted to carry on business in" the taxing State). This includes the State's power to tax dividends on income derived from property located and business transacted in the taxing State by a nondomiciliary company, see *id.* at 441-46 (rejecting due process challenge to Wisconsin tax on share of dividends issued by nondomiciliary corporation), even if this tax is imposed on a wholly out-of-state investor who receives the income, rather than on the payor who is engaged in the in-state business, see *Int'l Harvester Co. v. Wis. Dep't of Taxation*, 322 U.S. 435, 442, 445 (1944) (upholding Wisconsin tax on out-of-state shareholders' "privilege of receiving dividends" issued by nondomiciliary corporations engaged in business in Wisconsin because

Wisconsin "afforded protection and benefits to [corporations'] activities and transactions within the state").

States also may include in their apportionable tax base income generated by entities outside the taxing jurisdiction, so long as these entities are part of a "unitary" business, some part of which conducts business in the taxing State. Thus, this Court held in *Mobil Oil* that Vermont could tax Mobil's return on its "investments in affiliates and subsidiaries operating abroad," because Mobil did some business in Vermont and, although the affiliates and subsidiaries did not, they belonged to Mobil's unitary business. *Id.* at 435, 439-42 (internal quotation marks omitted). Likewise, the question in *F.W. Woolworth Co. v. Taxation & Rev. Dep't of N.M.*, 458 U.S. 354 (1982), was whether Woolworth conducted a unitary business with certain "foreign subsidiaries that [did] no business in New Mexico," which would allow the State to tax a share of the dividends that Woolworth received from those subsidiaries, *id.* at 356; and in *ASARCO*, it was whether Idaho could tax intangible income that a nondomiciliary company doing business in Idaho "receive[d] from subsidiary corporations having no other connection with the State," 458 U.S. at 308-09. By engaging in a unitary enterprise with a company acting in-state, even an entity with no other ties to the State maintains "the necessary relationship to opportunities, benefits, or protection conferred or afforded by the taxing State." *Woolworth*, 458 U.S. at 372 (internal quotation marks omitted).

Nor is business unity always required to tax even such far-flung subsidiaries or investees. "To be sure,

the existence of a unitary relation between the payor and the payee is one means of meeting the constitutional requirement" of minimal nexus, but it is "not the only one." *Allied-Signal*, 504 U.S. at 787. "[T]he unitary business concept * * * is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." *Container Corp.*, 463 U.S. at 167; see also *Allied-Signal*, 504 U.S. at 785 (same). It is enough, for example, that a capital transaction "serve an operational rather than an investment function," even when the payor and payee are not in a unitary relationship. *Allied-Signal*, 504 U.S. at 787.

It is within this constitutional framework that Mead must prove by "clear and cogent evidence" that Illinois's tax on a fraction of the gain realized by the Lexis/Nexis sale was unlawful. *Container Corp.*, 463 U.S. at 175 (internal quotation marks omitted). Mead fails to do so. Without even mentioning that Lexis/Nexis itself had a physical presence and conducted substantial business in Illinois, Mead relies on a narrow, inflexible reading of the "unitary business" and "operational function" doctrines to argue for an exception to States' long-recognized right to tax those who benefit from their "protection, opportunities and benefits." *ASARCO*, 458 U.S. at 315. Illinois sought to tax only a small portion of the more than $1 billion gain that Mead realized from the sale of Lexis/Nexis—a share commensurate with the goodwill value attributable to Lexis/Nexis's operations in Illinois, including its physical presence in-state, its use of Illinois employees, and its millions of dollars in sales

to Illinois consumers. J.A. 5-6, 55, 189. Indeed, had Lexis/Nexis been an independent company and Mead a mere investor who received dividends like other shareholders, the income that Mead received from Lexis/Nexis would have been subject to Illinois tax based on Lexis/Nexis's own Illinois operations. See *Int'l Harvester*, 322 U.S. at 439, 442, 445.

Mead insists, however, that by owning Lexis/Nexis outright and operating it alternately as a subsidiary and a division, without (in Mead's view) ever treating it as an "operational asset" or as part of Mead's "unitary business," it is entitled to a massive return on Lexis/Nexis's goodwill without subjecting even a fraction of that return to Illinois tax. In the constitutional middle ground that Mead envisions, a corporate division may do substantial business in a State—or nearly all of its business, for Mead's constitutional theory does not depend on the share of Lexis/Nexis's operations that occurred in Illinois—and therefore benefit substantially from the State's laws, infrastructure, and citizenry, without compensating the State for those benefits. As developed more fully below, this claim fails on several independent grounds.

II. The Constitution Permits Illinois To Tax An Apportioned Share Of The Lexis/Nexis Gain.

Under any standard, Illinois' claim to an apportioned share of the gain from Mead's sale of Lexis/Nexis was not an unconstitutional, extraterritorial tax. Lexis/Nexis was not a passive investment; Mead was conducting the electronic publishing business of Lexis/Nexis in Illinois either directly or through its unitary or operational

relationship with Lexis/Nexis. And even if one accepts Mead's view that Lexis/Nexis was a passive investment, the amount of the gain apportioned to Illinois fairly reflects Lexis/Nexis's activities in Illinois alone. For any or all of these reasons, Illinois is appropriately taxing only the income that arose in-state.[7]

A. Mead Actively Conducted Lexis/Nexis's Electronic Publishing Business In Illinois.

It is well settled that an out-of-state company is subject to tax in any State in which it conducts business. See *supra* pp. 18-19. Thus, in *Northwestern States Portland Cement Co. v Minnesota,* 358 U.S. 450 (1959), this Court rejected a constitutional challenge to a state tax on the portion of a nondomiciliary's net

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[7] The trial court upheld the tax at issue based on its determination that Lexis/Nexis served an operational function for Mead, Pet. App. 38a-40a, and the appellate court affirmed, Pet. App. 11a. As appellees, we may urge the Court to affirm the appellate court's judgment on any ground supported by the record. See, *e.g.*, *Thigpen v. Roberts*, 468 U.S. 27, 30 (1984); *United States v. N.Y. Tel. Co.*, 434 U.S. 159, 166 n.8 (1977); *Langes v. Green*, 282 U.S. 531, 538-39 (1931). Moreover, that we limited our Brief in Opposition to the operational function analysis—the basis for the appellate court's ruling—should be of no consequence. Consideration of our alternative arguments is "'predicate to an intelligent resolution of the question presented.'" *Caterpillar, Inc. v. Lewis*, 519 U.S. 61, 75 n.13 (1996) (quoting *Ohio v. Robinette*, 519 U.S. 33, 38 (1996)). All of our arguments are "fairly included" within the question presented, U.S. Sup. Ct. R. 14.1(a), and may properly be considered by this Court, see *Caterpillar*, 519 U.S. at 75 n.13; *Robinette*, 519 U.S. at 38; *Vance v. Terrazas*, 444 U.S. 252, 258-59 n.5 (1980).

income earned from business activities within the taxing State. See *id.* at 457-65.[8] In particular, the Court sustained efforts by Georgia and Minnesota to tax the income of out-of-state corporations, because the corporations had both solicited and obtained sales in these States. See *id.* at 453-57, 465. This was so even though the corporations at issue maintained nothing more than a sales office in the taxing States. See *id.* at 454-55. The States' income tax was proper, the Court explained, because, when a corporation "engage[s] in substantial income-producing activity" within a State, that State is entitled to ask that the corporation "carr[y] its fair share of its costs of the state government in return for the benefits it derives from within the State," *id.* at 462.

This case is no different. As the trial court correctly found, Mead itself actively conducted an electronic publishing business in Illinois (and elsewhere) through its Lexis/Nexis electronic publishing division. Pet. App. 36a-37a ("at all relevant times prior to the sale of Lexis/Nexis," Mead was "involved in the electronic publishing business" through its "business operations" in Lexis/Nexis). That is, as Mead's CEO acknowledged, Mead operated "two very good businesses," J.A. 44—a paper and packaging business and an electronic publishing business. In

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[8] In response to *Northwestern States'* constitutional holding, Congress enacted Public Law 86-272, which prohibits a State from taxing the income of a corporation whose only business activity within the State consists of "solicitation of orders" for tangible goods. 15 U.S.C. § 381(a); see *Wis. Dep't of Revenue v. Wrigley*, 505 U.S. 214, 232 (1992). Of course, Lexis/Nexis's activity went well beyond what the statute protects, and this law therefore has no bearing on the instant case.

short, Mead did not and cannot clearly and cogently disprove that it was conducting an electronic publishing business in Illinois, and this alone is grounds to affirm the decision below, separate and apart from the unitary business or operational function tests. See *Int'l Harvester*, 322 U.S. at 444-45; *J.C. Penney*, 311 U.S. at 441-42.[9]

In particular, the record amply demonstrates not only that the Lexis/Nexis electronic publishing division engaged in substantial business in Illinois, J.A. 14, and even maintained a physical presence there—Lexis Document Services headquarters were located in Springfield, Illinois, J.A. 104—but also that Mead controlled its electronic publishing division in numerous ways. Mead decided how Lexis/Nexis was managed and how and when it grew; Mead restructured Lexis/Nexis's corporate form, made its investment decisions, and even established the compensation Lexis/Nexis executives received upon divestiture; Mead imposed its management style and initiatives on Lexis/Nexis and shared its personnel; and, finally, Mead portrayed itself in the marketplace as a leader and innovator in the electronic publishing industry, and, not surprisingly, the marketplace perceived Mead exactly the same way.

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[9] This argument was not addressed in *Allied-Signal* or *ASARCO*, which limited their analyses to the unitary business and, in the case of *Allied-Signal*, operational function, tests. See *Allied-Signal*, 504 U.S. at 788-90; *ASARCO*, 458 U.S. at 320-29. In both cases, the taxpayer either lacked or declined to exercise control, and thus did not actively conduct the business at issue. See *infra* p. 39.

To start, Mead provided vital capital contributions until Lexis/Nexis became profitable, J.A. 169, and then, once Lexis/Nexis became successful, Mead encouraged and guided its growth through financial support and oversight of critical decision-making. To that end, Mead participated in and approved numerous acquisition decisions for Lexis/Nexis, as well as helped to implement those major purchases. J.A. 132-33. It was Mead, not Lexis/Nexis, that leased the $7.67 million central processing units "for use at Mead Central Data division." J.A. 132-33. And Mead authorized Lexis/Nexis to enter into agreements with other companies and spoke on behalf of Lexis/Nexis in executing those agreements. Indeed, in 1994 alone, Mead authorized Lexis/Nexis to enter into a partnership with American Lawyer Media and to contribute up to $10 million to that partnership, J.A. 137-38; entered into an agreement with Dow Jones & Company for Lexis/Nexis to distribute Dow Jones publications, J.A. 141; and approved Lexis/Nexis's acquisition of Journal Graphics, paying $200,000 out of its own pocket for the standstill agreement required by that acquisition, J.A. 144.

Mead exercised its control over Lexis/Nexis in myriad other ways. Most significantly, Mead repeatedly restructured Lexis/Nexis's corporate form. In 1980, Mead merged Lexis/Nexis, which had been operating as a wholly owned subsidiary, into Mead as a corporate division. J.A. 130-31. Then, in 1985, Mead separately reincorporated Lexis/Nexis, J.A. 147, only to merge it into Mead again in 1993, J.A. 134. Above and beyond the manipulation of Lexis/Nexis's corporate form, the record discloses other less striking but no less significant ways in which Mead exercised its control.

For example, Mead regularly reviewed Lexis/Nexis's business plan. J.A. 163. Mead undertook a nightly cash sweep of Lexis/Nexis's accounts, and Mead, not Lexis/Nexis, decided how to invest Lexis/Nexis's excess cash. J.A. 180-81. Similarly, when Mead sold Lexis/Nexis, it was Mead that determined what compensation and bonuses the Lexis/Nexis executives would receive. J.A. 146.

Mead also imposed its management style and initiatives on Lexis/Nexis and shared personnel. Lexis/Nexis thus participated in Mead's "three key initiatives" improvement program, and by all accounts did so successfully—showing marked improvements in customer satisfaction and high performance management, two of the "initiatives." J.A. 60-63. And while a Mead witness denied any sharing of personnel, each of the three executives who testified at trial admitted that he had worked for Mead and Lexis/Nexis at various points in his career. Record Vol. 9, RP 66, 94-96, 102, 114-15.

This level of involvement demonstrates conclusively that Mead was the operator not solely of a paper and packaging business, but also of an electronic publishing business. Indeed, Mead has never provided any authority that such activities are indicative of a passive investment. Corporate directors are not just a "passive instrumentality." 1-1 William E. Knepper & Dan A. Bailey, Liability of Corporate Officers & Directors § 1.02, at 1-5 (Allen Smith Co. 7th ed. 2006), as Mead seems to think, see Pet. Br. 34-36. Rather, they are "agents entrusted with the management of the corporation for the benefit of the stockholders." William E. Knepper, Liability of

Corporate Officers & Directors § 1.03, at 8 (Allen Smith Co. 1969) (citing *Pepper v. Litton*, 308 U.S. 295 (1939)). Indeed, if Mead's Board members had harbored no more than a passing interest in Lexis/Nexis's overall profitably, as Mead suggests, they likely would have contravened their corporate duties.

And, of course, Mead and its Board did have much more than a passing interest in Lexis/Nexis. That this is true is demonstrated by how Mead depicted itself to the world. Mead portrayed itself to the government, the public, and current and potential investors as a leader in the electronic publishing field. Mead boasted that *it* had developed "the world's leading electronic information retrieval" service. J.A. 59. It treated Lexis/Nexis as a business segment in its annual report and SEC filing, described itself as engaged in electronic publishing, and even listed "LEXIS," "NEXIS" and "Lexpat" as material Mead trademarks. J.A. 92-100, 102, 106-21, 126.

That Mead considered Lexis/Nexis as part of its business and not a mere investment is further shown by Mead's treatment of Lexis/Nexis as part of its own unitary business group for Illinois income tax purposes. J.A. 13. Mead may characterize its decision to include Lexis/Nexis on its Illinois combined unitary tax return as nothing more than an administrative convenience, undertaken to resolve a dis ute with the Department, J.A. 13; Pet. App. 67a n.7, but it is hard to believe that Mead would have included Lexis/Nexis in its unitary business group unless Mead actually

believed it was in the electronic publishing business.[10] After all, a Mead executive signed the unitary tax returns "under the penalt[y] of perjury." Record Vol. 4, C849.

Because Mead held itself out to the world as an electronic publisher, the marketplace predictably viewed Mead as just that. For this reason, an information technology analyst was surprised to learn of Mead's plans to sell "its product"—the computer information service that Mead had "pioneered" and done so much to "fix[]," and that was one of Mead's "growth industries." J.A. 50 (internal quotation marks omitted).

Finally, given the role that Lexis/Nexis played in Mead's bottom line, it is not surprising that Mead considered itself to be in electronic publishing.

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[10] Any implication that Mead included Lexis/Nexis in its unitary tax returns, which it did between 1988 and 1994, under duress is misplaced. As a result of filing this way, Mead benefitted from valuable tax deductions. J.A. 14, 147. Moreover, the Department relied on Mead's unitary filing position, even during the 1994 audit period. J.A. 53; Record Vol. 5, C1120. Mead should not now be allowed to adopt an inconsistent position. See *R.H. Stearns v. United States*, 291 U.S. 54, 61-62 (1934) (describing a duty of consistency in tax filings, to preclude a taxpayer from benefitting from "his own inequity or tak[ing] advantage of his own wrong"); see also *Beltzer v. United States*, 495 F.2d 211, 212-13 (8th Cir. 1974). Even Mead's expert agreed that would be unfair. Record Vol. 9, RP 107-08 (testimony of Walter Hellerstein) ("a business that is, and continues to be, treated as part of a unitary business, up to the time of the sale, and then at the time of the sale, because of an unusual transaction, the conclusion is that this gives rise to nonbusiness income, I regard as unfair from the standpoint of tax policy").

Lexis/Nexis accounted for a substantial share of Mead's business. In Illinois, Lexis/Nexis contributed over 20% of Mead's income from 1988 to 1993; even in 1994, the year it was sold, Lexis/Nexis still generated 13% of Mead's Illinois sales. J.A. 14; Vol. 4, C896.

Notwithstanding the fact that the marketplace viewed Mead exactly as Mead had intended—as an electronic publisher—Mead tries to distance itself from its annual report and SEC filing. See Pet. Br. 40-41; see also Gannett Br. 14-17; COST Br. 15; Disney Br. 17. Mead's claim that these documents show nothing more than how "the company listed its profit entry on a financial statement," Pet. Br. 41 (citation and internal quotation marks omitted), misses the broader narrative import of those public statements. The annual report and 10-K filing demonstrate Mead's view of the scope of its business, and, in so doing, contradict the testimony of Mead's witnesses that Lexis/Nexis was considered merely a passive investment.

Along the same lines, amici's argument that annual reports and 10-K statements are irrelevant because they are governed by a specific accounting rule, "FAS 131," see Gannett Br. 14-16, Disney Br. 18, misses the mark. FAS 131 provides some quantitative basis for including a business as an operating asset. See Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise & Related Information* (1997). But it provides the reporting entity with considerable leeway as to how it characterizes its business. See generally FAS 131; see also 17 C.F.R. § 229.101 (requiring general description of business). Nothing in FAS 131 required Mead to

state that it "manufactures and distributes school and office supplies, distributes paper and other industrial supplies *and is engaged in the electronic publishing business*." J.A. 92-93 (emphasis added).[11]

In sum, Mead's actions, singly or in combination, were not characteristic of a passive investor. To the contrary, Mead was running a multistate electronic publishing business in Illinois and elsewhere through its Lexis/Nexis division; accordingly, Illinois may tax Mead on a fraction of the gain it realized on the sale of that division.

B. Lexis/Nexis Was Part Of Mead's Unitary Business Or Was An Operational Asset of Mead.

Even if this Court were to conclude that Mead did not actively engage in the electronic publishing business through Lexis/Nexis, the record demonstrates that Mead's paper and packaging business and its electronic publishing line had a unitary relationship or, as both Illinois courts found, that Lexis/Nexis was an operational asset of Mead. Either way, Mead was not merely a passive investor in Lexis/Nexis, and a small fraction of the Lexis/Nexis sales proceeds are therefore subject to Illinois tax.

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[11] Although Mead argued below that the annual report and SEC filing should not be considered, the Illinois Appellate Court noted that Mead had identified no authority in support of this proposition. Pet. App. 13a. Indeed, this Court long has relied on annual reports in its decisions evaluating income apportionability. See *Container Corp.*, 463 U.S. at 180 n.19; *Woolworth*, 458 U.S. at 369.

As noted above (at p. 19), the concept of a unitary business "is not, so to speak, unitary." *Container Corp.*, 463 U.S. at 167. Ignoring formal distinctions between business units, see, *e.g.*, *Mobil Oil*, 445 U.S. at 440-41, this Court has described a "unitary" business variously as one having "functional integration, centralization of management, and economies of scale," *Exxon Corp. v. Wis. Dep't of Revenue*, 447 U.S. 207, 222 (1980) (citing *Mobil Oil*, 445 U.S. at 438); one in which the different arms of the business exhibit "substantial mutual interdependence," *Woolworth*, 458 U.S. at 371; and as an "organic system" in which out-of-state assets add value to the property and rights within the taxing state, *Bass, Ratcliff & Gretton v. State Tax Comm'n*, 266 U.S. 271, 280-82 (1924). Broadly speaking, a unitary business involves a "sharing or exchange of value" between a business' in and out-of-state activities "not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or distinct business operation—which renders formula apportionment a reasonable method of taxation." *Container Corp.*, 463 U.S. at 166.

The "operational function" standard is a corollary to the unitary business test, for both inquiries ask whether income "was earned in the course of activities []related to those carried out in the taxing State." *Allied-Signal*, 504 U.S. at 787 (internal punctuation omitted); 1 Jerome Hellerstein & Walter Hellerstein, State Taxation, 8-95 to 8-96 n.426 (Warren, Gorham & Lamont 3d ed. 2000) [hereinafter *State Taxation*] (noting that "both tests are corollaries of the broad proposition that 'the linchpin of apportionablity * * * is

the unitary business principle'") (quoting *Mobil Oil.*, 445 U.S. at 439); accord Tax Executive Institute ("TEI") Br. 10 (operational function test is "gloss" on unitary principle).

The two doctrines call for slightly different inquiries, however. Whereas the business unity test turns on factors such as synergies, economies of scale, and overlapping personnel, the operational function test "focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *Allied-Signal*, 504 U.S. at 785 (citing *Container Corp.*, 463 U.S. at 180 n.19); see also *Allied-Signal*, 504 U.S. at 787. Commentators have clarified this distinction: "The essential question under the operational-function test is whether the intangible asset is part of the corporate taxpayer's *own* unitary business, not whether two separate corporations are engaged in a common enterprise." *State Taxation*, at 8-95 to 8-96 n.426 (emphasis in original); see also Walter Hellerstein, *State Taxation of Corporate Income from Intangibles:* Allied-Signal *& Beyond*, 48 Tax L. Rev. 739, 791 (1993) [hereinafter Allied-Signal *& Beyond*]. Thus, while the same facts may evidence both business unity and an operational function, see *State Taxation*, at 8-95 to 8-96 n.426, in identifying an operational asset, this Court looks specifically for objective evidence of management's role in ensuring the asset's growth and at the asset's role in the taxpayer's business operations in the taxing state. See *Allied Signal,* 504 U.S. at 785; *Container Corp.*, 463 U.S. at 180 n.19; see also *ASARCO*, 458 U.S. at 323.

In the end, the constitutional question ultimately hinges on what Mead *actually* contributed to Lexis/Nexis's Illinois operations and what Lexis/Nexis *actually* contributed to Mead's Illinois operations. See *Allied-Signal*, 504 U.S. at 787-88; *Container Corp.*, 463 U.S. at 178-79; *Woolworth*, 468 U.S. at 371-72. The facts demonstrate that those contributions were substantial and—under either doctrine—supported the Illinois courts' finding that the gain was apportionable.

1. Mead and Lexis/Nexis Were a Unitary Business.

Mead and Lexis/Nexis operated as a unitary business, as this Court's decision in *Container Corporation* demonstrates. Container Corporation ("Container") was a Delaware corporation, doing business in California and elsewhere, with foreign subsidiaries operating abroad. See 463 U.S. at 163. Container held a controlling interest in each subsidiary; it sold products to the subsidiaries, but only in an amount equal to "about 1% of the subsidiaries' total purchases"; "[t]he subsidiaries were * * * relatively autonomous with respect to matters of personnel and day-to-day management," which were "left in the hands of local executives"; "[t]here was no formal United States training program for the subsidiaries' employees"; and "[a]lthough local decisions regarding capital expenditures were subject to review by [Container], problems were generally worked out by consensus rather than outright domination." *Id.* at 171-72. Notwithstanding these facts, this Court applied unitary business principles to uphold California's tax on a share of the gain realized

by Container's offshore subsidiaries. Critically, the Court reached this conclusion for reasons that apply equally here.

In particular, the Court found it material that Container assisted "its subsidiaries in obtaining used and new equipment." 463 U.S. at 179. Mead's involvement in Lexis/Nexis's procurement efforts was far more extensive. It supervised Lexis/Nexis's important acquisition decisions and helped to implement those decisions once made. J.A. 133. In one instance, Mead leased $7.67 million central processing units for Lexis/Nexis's use. *Id.* at 132-33.

In *Container Corporation*, the Court cited the fact that Container "loan[ed] funds to the subsidiaries and guarantee[d] loans provided by others" to promote the subsidiaries' growth and profitability. 463 U.S. at 179, 180 n.19. Mead was far more actively involved in promoting Lexis/Nexis's financial success. Before Lexis/Nexis became profitable, Mead gave (not loaned) money to Lexis/Nexis, J.A. 169, and Mead collected and invested Lexis/Nexis's excess cash using Mead's own banking relationships, J.A. 180-81. Such economies of scale are emblematic of a unitary business. See *Container Corp.*, 463 U.S. at 179, 180 n.19.

Mead's amici emphasize that the nightly cash sweep is not evidence of a flow of value between Mead and Lexis/Nexis. See Gannett Br. 11-13; COST Br. 15; Disney Br. 15-16. But the point is not that Mead and Lexis/Nexis commingled funds, as the amici suggest; it is that Mead performed a valuable task on Lexis/Nexis's behalf, at no cost to Lexis/Nexis, and

therefore went well beyond the role of a passive investor. See *Container Corp.*, 463 U.S. at 180 n.19; cf. *Woolworth*, 458 U.S. at 364 n.11 (mere commingling of subsidiary's dividends with corporate funds did not in and of itself show that discretely operated businesses were unitary).

In addition, the Court in *Container Corporation* cited the taxpayer's "technical assistance" to its subsidiaries, coupled with the "supervisory role played by [Container's] officers in providing general guidance to the subsidiaries." 463 U.S. at 179. Mead provided substantial guidance and advice to Lexis/Nexis. In many instances, Mead's managerial role went beyond the "technical" and "advisory," as when Mead funded, executed, or approved contracts on Lexis/Nexis's behalf. J.A. 141, 144; see *Container Corp.*, 463 U.S. at 173 n.9 (finding it significant that, "[i]n at least one instance, appellant became involved in the actual negotiation of a contract between a customer and a foreign subsidiary"). Moreover, on top of its role in reviewing Lexis/Nexis's business plan and managing Lexis/Nexis's more significant expenditures, Mead infused Lexis/Nexis with Mead's own management principles, exemplified by the company-wide "three key initiatives" program, which Lexis/Nexis dutifully implemented. J.A. 60-63.

Accordingly, Mead and its amici mischaracterize the record when they say that Mead merely "kept track of" Lexis/Nexis's performance as any "prudent investor" would or, alternatively, engaged in nothing more than limited strategic decision-making. See, *e.g.*, Pet. Br. 34-35; COST Br. 11-17; Disney Br. 18-20.

Moreover, Mead points to its supposed lack of day-to-day management over Lexis/Nexis, Pet. Br. 8-10, but the same lack of day-to-day management was true of Container's relationship with its overseas subsidiaries, see 463 U.S. at 172, and the Court not only found a unitary relationship in that case, but also emphasized that "mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding," *id.* at 180 n.19. Indeed, Mead's arrangement with Lexis/Nexis was characteristic of Mead's relationship with every one of its business segments, even those that were unquestionably part of its unitary business. They were all largely left to run themselves. Record Vol. 9, RP 109, 111-12; J.A. 127, 163-64. Thus, the presence or absence of day-to-day management is never dispositive. What matters is "whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy." *Container Corp.*, 463 U.S. at 180 n.19. Container satisfied this standard by sharing "business 'guidelines'" with its subsidiaries, managing by consensus, and furnishing some "uncompensated technical assistance." *Id.* Mead did so with involvement in decisions on significant expenditures, contract work on Lexis/Nexis's behalf, and programs like "key initiatives."

To be sure, this case is not factually identical to *Container Corporation.* Thus, for example, the taxpayer in that case was engaged in the same basic line of business as its subsidiaries. 463 U.S. at 172. But this distinction is immaterial. Indeed, the Court emphasized the relative insignificance of this fact and

observed that it was of "limited use" to the California court in upholding the tax. *Id.* at 178. In other respects, moreover, the differences between *Container Corporation* and this case demonstrate a far greater "flow of value"—the loadstar of the unitary business inquiry, see *id.*—between Mead and Lexis/Nexis than existed between Container and its subsidiaries. Beyond the value that Mead imparted to Lexis/Nexis, in the form of capital infusions and free money management, Mead derived substantial value from Lexis/Nexis. Mead used Lexis/Nexis to obtain more than $680 million in tax deductions over five years (in Illinois alone) and admitted to manipulating Lexis/Nexis's corporate form repeatedly to capitalize on additional millions of dollars in tax savings. J.A. 14, 130-31, 134-35, 147, 149.

Mead also held itself out to the government, its investors, and the public broadly as a leader in electronic publishing, and filed unitary tax returns in combination with Lexis/Nexis. Record Vol. 4, C849, C856-68; J.A. 59, 92-100, 102, 104, 120-21, 126. The finding of a unitary business in *Container Corporation*, where many of these additional facts were absent, compels the same finding in this case.

Woolworth, *ASARCO*, and *Allied-Signal* are not to the contrary, for the relationship between Mead and Lexis/Nexis is readily distinguished from the passive investments found to exist in those cases. See generally *Container Corp.*, 463 U.S. at 179 (distinguishing *ASARCO* and *Woolworth*). In *Woolworth*, for instance, "*no* phase" of the taxpayer and subsidiary businesses was interrelated. 458 U.S. at

365 (emphasis in original). The Court found it relevant that each subsidiary in that case was responsible for obtaining its own financing, see *id.* at 366; Woolworth had no training program to impart its retail philosophy to its subsidiaries, and no corporate department to oversee the subsidiaries' operations, see *id.* at 366-67; and Woolworth and its subsidiaries did not file consolidated tax returns, see *id.* at 368. Corporate oversight in that case was limited to deciding on dividends, approving substantial debt, and including consolidated financial statements in the annual report. See *id.* at 368-69. In contrast, Lexis/Nexis relied on Mead for financing, J.A. 154-55, 169; Mead imposed its management program on Lexis/Nexis, J.A. 60-63; a Mead corporate committee oversaw Lexis/Nexis's growth, J.A. 132; and Mead and Lexis/Nexis filed combined unitary Illinois tax returns, Record Vol. 4, C849.

Allied-Signal and *ASARCO* are likewise inapposite. In these cases, the taxpayer either was a minority shareholder and thus lacked a controlling interest, see *Allied-Signal*, 504 U.S. at 788 (20.6% interest); *ASARCO*, 458 U.S. at 323-24 (34% and 49% interests); had voluntarily relinquished control, see *ASARCO*, 458 U.S. at 321-22; or had stipulated that the businesses had no connection with each other, see *Allied-Signal*, 504 U.S. at 774. Mead, by contrast, not only had a controlling interest in Lexis/Nexis, but exercised its control in the myriad ways previously described.

In sum, Mead and Lexis/Nexis operated as a unitary business, and although this issue was not

reached below, it provides an independent basis to affirm the judgment of the Illinois Appellate Court.

2. Lexis/Nexis Was an Operational Asset of Mead.

In the alternative, if this Court were to conclude that Mead and Lexis/Nexis did not operate as a unitary business, the Illinois Appellate Court's decision should be affirmed because that court correctly concluded that Lexis/Nexis was Mead's operational asset. Pet. App. 14a. In particular, the court noted that Mead owned 100% of Lexis/Nexis and, critically, determined that while "Mead did not have day-to-day control over Lexis/Nexis, its involvement with Lexis/Nexis was more than merely passive." *Id.* at 13a. The court supported this conclusion with a number of specific findings: Mead contributed capital to Lexis/Nexis, approved major expenditures, manipulated Lexis/Nexis's corporate structure for Mead's advantage, appropriated its tax benefits, and exercised control over its excess cash. *Id.* at 12a-13a. Moreover, Mead's annual report and SEC filing showed that Mead considered itself to be in the electronic publishing business, and viewed Lexis/Nexis as a business segment rather than an investee. *Id.* at 13a. The lower court's conclusion that Lexis/Nexis was an operational asset rather than a passive investment was correct, and at the very least falls well "within the realm of permissible judgment," the standard by which this Court reviews this determination. *Container Corp.*, 463 U.S. at 180 (internal quotation marks omitted).

Of the facts on which the appellate court relied, one alone is likely sufficient to show that Lexis/Nexis was an operational asset, rather than a passive investment (and this fact certainly suffices in combination with the others on which the court relied)—Mead regularly manipulated Lexis/Nexis's corporate form to obtain valuable tax savings, capturing Lexis/Nexis's loss carryforwards. Mead bore the burden of proof at trial, yet nothing in the record suggests that Mead's acquisition of these carry forwards and other tax benefits worth millions of dollars occurred at arm's length. To the contrary, Mead paid only $350,000 to effect its latest merger with Lexis/Nexis, in 1993, in exchange for millions of dollars in "estimated annual savings." J.A. 147. Such actions go well beyond what a passive investor could do.

Mead and its amici downplay Mead's manipulation of Lexis/Nexis, see, *e.g.*, Pet. Br. 38-39; COST Br. 14, but what Mead did is no different than purchasing paper or other products from Lexis/Nexis at below-market rates. Using its Lexis/Nexis division to secure below-cost tax savings for itself just as surely serves "an operational rather than an investment function." *Allied-Signal*, 504 U.S. at 787.

Mead's only hope is to characterize this Court's "operational function" language in *Allied-Signal* as an insignificant gloss on, or "narrow exception" to, the unitary business doctrine, and elsewhere to argue that any fact tending to show a unitary business is immaterial to the operational function analysis. Pet. Br. 25, 36-41 (emphasis omitted); see also Gannet Br.

6; Disney Br. 10, 12-14; COST Br. 8-9. But neither of these views square with *Allied-Signal* itself.

First, *Allied-Signal* makes clear that the "operational function" test is not limited to one or two narrow exceptions, as Mead contends. The Court did suggest examples of an operational relationship—interest on short-term deposits in out-of-state banks, where the interest is used as working capital, and the investment in *Corn Prods. Refining Co. v. Comm'r*, 350 U.S. 46 (1955), which ensured a supply of a producer's key ingredient, *Allied-Signal*, 504 U.S. at 787-88—but these illustrations were not exclusive. The court made clear that the first was merely an "example," and referred to *Corn Products* only in passing. *Id.* at 787-88; accord *State Taxation*, at S8-7 (2006 Supp.) ("Although the Court in *Allied-Signal* gave two examples of investments that served an operational function, there was no suggestion that those examples were exclusive.").[12] The ultimate question remains whether the taxpayer can "prove that the income was earned in the course of activities unrelated to [those carried out in the taxing] State," *Allied-Signal*, 504 U.S. at 787 (internal quotation marks omitted) (alterations in original), and courts

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[12] Mead purports to add two more examples: "'loan and loan guarantees' that support 'operations' in the same line of work as the unitary business," Pet. Br. 30 (citing *Container Corp.*, 463 U.S. at 180 n.19), and "nonunitary 'stock investments'" which have been "'accumulated for the future operation'" of the taxpayers' "'own primary business,'" *id.* at 31 (citing *ASARCO*, 458 U.S. at 324 n.21). Mead thereby implicitly rejects its own argument, made in its Petition for Certiorari (at p. 16), that the operational function test is limited to the two examples mentioned in *Allied-Signal*.

may consider any fact material to that ultimate inquiry.

Certainly, the view that no operational relationship may be found between two different lines of business, see Gannett Br. 17-18, is incorrect. Indeed, such a rule would encourage the sort of corporate manipulation that apportionment was designed to prevent. See *Mobil Oil*, 445 U.S. at 440-41. This is because the more a multistate corporation diversified, the less likely the corporation would be taxable in any State, because it would always be able to claim that it was merely a passive investor in subsidiaries that undertake different lines of business. As we have explained (see *supra* p. 18-19), apportionment is intended to ensure that a State receives a just return for the benefits and opportunities it has conferred on in-state business activity. Apportionment has nothing to do with the form a business organization takes.

Second, far from holding that facts must be assigned rigidly either to the "unitary business" or to the "operational function" inquiry, *Allied-Signal* makes plain that the two standards are related means of distinguishing income-generating assets that perform mere investment functions from those that are operational. See 504 U.S. at 785, 787. Thus, the two approaches to constitutional apportionment are, as explained above (see *supra* pp. 32-33), corollaries of the constitutional nexus requirement rather than wholly distinct lines of analysis. See *State Taxation*, 8-95 to 8-96 n.426. Therefore, contrary to Mead's repeated suggestions, see Pet. Br. 36-41; see also COST Br. 12-

13, it was perfectly proper for the Illinois Appellate Court to support its "operational function" finding with facts that would also tend to show a unitary business. Moreover, Mead's effort to divide the facts between the unitary business and operational function inquiries ignores that the facts in combination are what demonstrate whether the constitutional test was met, regardless of whether any one fact alone shows the requisite constitutional link. See *Container Corp.*, 463 U.S. at 179-80. Thus, Mead's view that this Court should limit its analysis to the flow of benefits from Lexis/Nexis to Mead, and should not consider the benefits that flowed from Mead to Lexis/Nexis, see Pet. Br. 33-34, finds no support in the caselaw. Because the unitary business and operational function tests are not mutually exclusive, both types of evidence may and should be considered when evaluating operational purpose.

Finally, although Mead relies heavily on *Allied-Signal*, see Pet. Br. 30-36, that reliance is misplaced. The taxpayer there owned only 20.6% of its investee's stock and had no way to control the investee; moreover, the parties had stipulated that each business "had nothing to do with the other." See 504 U.S. at 788. In contrast, Mead owned all of Lexis/Nexis. More important, at the time of sale Lexis/Nexis was a *division* of Mead, not a subsidiary; as such, Mead both could and did control its business operations.

That being said, we do not claim that ownership is a sufficient condition to show an operational function. Indeed, Mead and its amici mischaracterize the Illinois Appellate Court's decision as relying entirely on Mead's

100% ownership of Lexis/Nexis. See Pet. Br. 38, 49-50; Disney Br. 14; TEI Br. 12. To the contrary, Mead's sole ownership of Lexis/Nexis was merely one of the factors the court considered. Pet. App. 12a-13a.[13] Crucially, the court based its finding of operational purpose on its recognition that Mead *exercised control over* Lexis/Nexis in myriad ways and held itself out to the world as an electronic publisher rather than a mere investor in Lexis/Nexis. *Id.* at 13a. But it cannot be denied that the ability to control a business is a necessary condition of showing actual control, and thus the court properly cited Mead's 100% ownership of Lexis/Nexis as relevant. See *Container Corp.*, 463 U.S. at 177 n.16 (noting that ability to control is relevant but not dispositive of unitary analysis) (citing *Woolworth*, 458 U.S. at 362).

In sum, Mead has failed to carry its burden of proving clearly and cogently that Illinois is taxing extraterritorially, or to show that the Illinois Appellate Court's decision is outside "the realm of permissible judgment," *Container Corp.*, 463 U.S. at 176, in holding that Lexis/Nexis was an operational asset of Mead.

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[13] Because the Illinois Appellate Court did not equate ownership with apportionability, sustaining that court's decision will not, as Mead argues, see Pet. Br. 49-50, run afoul of "apportionment formulae that have been in place for more than 50 years," *id.* at 49, or otherwise result in misattribution of income.

C. Even If Mead Were A Passive Investor In Lexis/Nexis, Illinois Acted Properly, For The State Taxed Only That Portion Of Mead's Gain Reflecting Lexis/Nexis's Illinois Activities.

As we explain, under no fair reading of the facts was Mead merely a passive investor in Lexis/Nexis. To the contrary, because the control Mead exercised was such that it essentially operated Lexis/Nexis in Illinois, or at the very least had a unitary or operational relationship with Lexis/Nexis, there was no error in the lower courts' determination that Illinois's tax was proper. That said, even if, as Mead urges, Lexis/Nexis is viewed purely as a passive investment, that would not change the outcome of this case. To the contrary, it is well settled that a State may tax the income an out-of-state corporation derives from its investment in another out-of-state corporation where, as here, the tax fairly reflects the benefits and protections the State has provided the investee.

This follows from the established principle that a State has the power to tax income earned within its borders. See *Int'l Harvester*, 322 U.S. at 441; *J.C. Penney*, 311 U.S. at 446. As the Court has explained,

> [a] state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of

> the state and entitled to the numerous benefits which it confers.

Int'l Harvester, 322 U.S. at 441-42. A tax based on the investee's in-state earnings fairly reflects the benefits, protections, and opportunities provided by the taxing State. See *id.* at 444 ("the incidence of the tax as well as its measure is tied to the earnings which the [State] has made possible"); *J.C. Penney*, 311 U.S. at 444 ("The simple but controlling question is whether the state has given anything for which it can ask return."); see also *Bridges v. Autozone Prop., Inc.*, 900 So. 2d 784, 809 (La. 2005); *Geoffrey, Inc. v. S.C. Tax Comm'n*, 437 S.E.2d 13, 18 (S.C. 1993).

Applying this principle in *International Harvester*, this Court held that Wisconsin could tax nonresident shareholders on dividends issued by a nondomiciliary corporation where the dividend amounts subject to the tax were fairly attributable to its Wisconsin earnings. See 322 U.S. at 442-43; see also *Allied-Signal Inc. v. Comm'r of Fin.*, 588 N.E.2d 731, 737-38 (N.Y. 1991) ("*Allied-Signal II*") (New York City could constitutionally tax nondomiciliary's investment income in another company that conducted business in city where income was apportioned based on investee's New York City attributes); accord Allied-Signal & *Beyond*, 48 Tax L. Rev. at 817-18 (noting with approval holding of *Allied-Signal II* that "a state may tax the income derived from a nondomiciliary corporation from its investment in another corporation if the state has provided benefits and protections to other such corporation").

Thus, even if Lexis/Nexis was nothing more than a passive investment for Mead, Illinois could properly tax the gain Mead realized from the sale of Lexis/Nexis, so long as Illinois limited its taxation to the fraction of the gain that was attributable to Lexis/Nexis's activities in Illinois. That is exactly what happened here.

Illinois assessed a tax on the gain in the goodwill value of Lexis/Nexis's business. J.A. 5-6, 26, 55; Record Vol. 9, RP 228. "Goodwill" is defined as "'that element of value which inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business.'" *Newark Morning Ledger v. United States*, 507 U.S. 546, 555 (1993) (quoting *Des Moines Gas Co. v. Des Moines*, 238 U.S. 153, 165 (1915)). As such, goodwill arises from "'the general public patronage and encouragement'" a business "'receives from constant or habitual customers on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality * * *.'" *United States v. Winstar Corp.*, 518 U.S. 839, 849 n.5 (1996) (quoting J. Story, Partnerships § 99 (1841)). As these definitions make plain, the goodwill value of an enterprise is directly associated with any State in which the enterprise does business. That is, by providing the orderly society in which Lexis/Nexis conducted its business, Illinois made it possible for Lexis/Nexis to accrue goodwill.

Because Illinois helped to create the income at issue here, Illinois should not be prevented from assessing a tax on its constitutionally permissible share of that income. Significantly, Illinois sought to

tax no more than that portion of Lexis/Nexis's goodwill that was generated within its borders. In apportioning the Lexis/Nexis gain to Illinois, the Department included only $40.6 million of the $1.05 billion gain to Mead in the apportionment factors. J.A. 5. The $40.6 million attributable as Illinois earnings, which amounted to less than 4% of the total gain, was calculated using only Lexis/Nexis's own Illinois factors. J.A. 55, 186.[14] Thus, the record shows that the Department's apportioned share fairly reflects those values that contributed to the goodwill realized from Lexis/Nexis's Illinois activities.

Because Illinois sought to apportion only the share of the Lexis/Nexis gain actually attributable to Illinois, the State was exercising its taxing powers to capture only the income earned in Illinois. That does not violate the Constitution. See *Int'l Harvester*, 322 U.S. at 443-44; see also *Allied-Signal II*, 588 N.E.2d at 737-38. Moreover, if Mead believed that Illinois's approach did not fairly reflect *Lexis/Nexis*'s in-state earnings, Mead could have petitioned the Director of the Department for alternative apportionment under 35 ILCS 5/304(f) (1994). However, as the appellate court recognized, Pet. App. 17a, Mead brought no such petition.

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[14] In fact, Lexis/Nexis's average apportionment percentage of 3.7%, J.A. 189, was remarkably close to Mead's average apportionment percentage of 4.1%, J.A. 28.

III. Mead's Policy Arguments Do Not Persuade.

For the foregoing reasons, the Constitution permits Illinois to tax a portion of the gain from Mead's sale of Lexis/Nexis. Nevertheless, Mead and its amici advance several policy rationales that they believe warrant imposing additional limitations on Illinois's ability to impose the tax at issue. We address these arguments in turn.

A. There Is No Threat Of Prohibited Multiple Taxation.

First, Mead and its amici raise the specter of prohibited multiple taxation if even a fraction of Mead's gain from the sale of Lexis/Nexis is subject to Illinois tax. See Pet. Br. 50-53; COST Br. 17; Disney Br. 26; TEI Br. 17. According to this view, because Mead is domiciled in Ohio, and Ohio, at least theoretically, has the authority to tax the gain in its entirety, the Constitution does not permit any other State to tax any portion of that gain, regardless of the extent to which Lexis/Nexis did business in that State.

We may quickly put aside any claim of multiple taxation in this case. Mead has never presented any evidence that it will be subject to multiple taxation if the Illinois Appellate Court's decision is upheld. To the contrary, Mead implicitly concedes that Ohio has not taxed the entire gain and, thus, that no multiple taxation will occur. See Pet. Br. 53 n.13 ("That Ohio's tax code may not actually tax the entire transaction is of no consequence."). Indeed, it is highly probable that Ohio has not taxed the entirety of the gain. This is because under the apportionment principles in effect in

Ohio in 1994—which are similar to Illinois's apportionment principles—Ohio likely would have characterized the gain as apportionable business income because it was reinvested back into Mead's business. See, *e.g.*, *Kemppel v. Zaino*, 746 N.E.2d 1073, 1075 (Ohio 2001). Accordingly, at most, Ohio would have apportioned a fraction of the gain, rather than allocate the entire gain to itself. The result is that "actual multiple taxation is not demonstrated on this record." *Mobil Oil*, 445 U.S. at 444. In its challenge to alleged multiple taxation, therefore, Mead does not "seek[] relief from a present tax burden"; at best, it "seeks to establish a theoretical constitutional preference for one method of taxation over another." *Id.*

In any event, even if Mead could show duplicative taxation in this case, this Court squarely held in *Mobil Oil* that multiple taxation under circumstances analogous to these does not contravene the Constitution. In *Mobil Oil*, the taxpayer, a New York domiciliary, claimed that because New York had the power to tax all of its dividend income without apportionment, the Commerce Clause did not permit Vermont to tax even an apportioned share of that income. See 445 U.S. at 443-44. This Court flatly rejected the argument. As the Court explained, the law recognizes no preference for allocation over apportionment. See *id.* at 444-45. Furthermore, "the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy." *Id.* at 444. Rather, because the dividends reflected income of a business conducted in several States, including Vermont, the income "b[ore] relations to the benefits

and privileges conferred by [those] states." *Id.* at 446. As a result, Vermont could properly tax its proportionate share of that income. See *id.* Thus, whatever power New York had to reach the taxpayer's income, such power was not exclusive when the income in question arose from the operation of the taxpayer's business conducted partly in Vermont. See *id.* at 445-46.

Just so here. Because the requirement of a minimal nexus between Illinois and the activities giving rise to Lexis/Nexis's gain is more than adequately met, the fact that Ohio also may have a right to tax this income does not render Illinois's apportionment of that same income unconstitutional. See *Mobil Oil*, 445 U.S. at 445-46; see also *State Taxation*, at 6-13 (recognizing constitutional preference for apportionment by income source State when its powers conflict with those of State of residency); William D. Dexter, *Tax Apportioment of the Income of a Unitary Business: An Examination of* Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 1981 BYU L. Rev. 107, 130 (1981) (same).

Thus, Mead's reliance on *Cent. Greyhound Lines, Inc. v. Mealy*, 334 U.S. 653 (1948), is misplaced. In *Central Greyhound*, the Court invalidated an unapportioned gross receipts tax on interstate travel because "[b]y its very nature" the tax at issue "ma[de] interstate transportation bear more than a fair share of the cost of the local government whose protection it enjoys." *Id.* at 663 (citation and internal quotation marks omitted). That is a far cry from this case, in which Illinois seeks to tax only its apportioned share of

the gain based on the percentage of business Lexis/Nexis conducted in Illinois. Moreover, even in *Central Greyhound*, the Court recognized that there would have been no constitutional problem had the tax been "fairly apportioned to the business done within the state by a fair method of apportionment." *Id.* (citation and internal quotation marks omitted). Thus, *Greyhound* supports rather than undermines Illinois's approach to taxation.

B. Allowing Illinois To Tax A Fraction Of The Gain Will Not Raise Transaction Costs For Multistate Corporations.

Second, Amicus Disney describes a doomsday scenario under which allowing taxation in this case may "hamper * * * economically beneficial merger and acquisition activity" by requiring multistate companies to suffer potentially negative tax consequences when acquiring a so-called "unwanted business"—that is, a business the purchaser has no intention of running but plans to hold as an investment until the market is ripe for sale—as part of a merger. Disney Br. 22-23.

This argument is wholly conjectural. The tax treatment of an acquisition depends on many facts—including some that are within the taxpayer's control, such as which entity realizes the gain, as well as the particular taxpayer's relationship to the specific business asset and activities in the taxing State. How these multiple factors will manifest themselves in any particular acquisition is entirely speculative.

In any case, Lexis/Nexis was hardly an "unwanted business." That is clear from the statement of Mead's CEO that the divestiture of Lexis/Nexis was "probably the toughest decision I've ever had to make." J.A. 42-44. Moreover, for the myriad reasons developed above, Lexis/Nexis was not a mere investment but was part of Mead's operating business. Disney's analogy to an "unwanted line of business," Disney Br. 23, is therefore inapplicable to this case.

C. Affirming The Illinois Appellate Court Will Not Upset Settled Expectations.

Finally, Mead and its amici advance the erroneous view that the decision of the Illinois Appellate Court in this case conflicts with the decisions of other state courts, see Pet. Br. 47-49, and, moreover, that sustaining that decision would "upset * * * decisions made in reliance on *Allied-Signal*," Disney Br. 25-26. As we explain above (see *supra* pp. 25 n.9, 39, 41-44), the decision below fully complies with *Allied-Signal*; accordingly, affirmance of that decision would not "repudiate" *Allied-Signal*, Disney Br. 25, much less amount to its "formal overruling," *id.* Indeed, the cases cited by Mead demonstrate that state courts have in large part aptly applied the *Allied-Signal* test, and there is nothing inconsistent in the Illinois court's application here.

For example, in *Hoechst Celanese Corp. v. Franchise Tax Bd.*, 22 P.3d 324 (Cal. 2001), the California Supreme Court found that the gain realized from a partial reversion of the taxpayer's pension trust fund was operational income, despite the fact that the

corporate taxpayer did not hold legal title to the trust fund assets. See *id.* at 328-30. The income was apportionable under the operational function test because the taxpayer funded the plan, oversaw the plan by choosing its management and guiding its overall investment strategy, and because the plan—by supporting the taxpayer's retention and recruitment efforts—made better use of the taxpayer's employees, a business-related resource. See *id.* at 344-45.

Thus, in reaching its conclusion that the trust fund was the taxpayer's operational asset, the *Hoechst Celanese* court relied on many of the same facts that the Illinois Appellate Court did—capital support, investment oversight and control, as well as that the asset freed up the taxpayer to make better use of existing business resources (a function here played by Mead's use of Lexis/Nexis's net loss carryforwards and other tax deductions). Indeed, while Mead describes *Hoechst Celanese* as "confin[ing] the operational function test to the two circumstances previously articulated by this Court," Pet. Br. 48, this is incorrect. *Hoechst Celanese* recognized, as did the appellate court here, that the operational function inquiry is not a narrow exception to the unitary business test, but a corollary to that test that considers many of the same factors.

Alaska Dep't of Revenue v. OSG Bulk Ships, Inc., 961 P.2d 399 (Alaska 1998), and *Pennzoil Co. v. Dep't of Revenue*, 33 P.3d 314 (Or. 2001), similarly do not support Mead's contention, see Pet. Br. 48, that the operational function inquiry is but a limited exception to the unitary business test. Neither of these cases

involved a capital transaction, and thus both are distinguishable on their facts from the instant case. And, in any event, neither case supports the narrow view of the operational function test that Mead advocates. Indeed, in *OSG Bulk Ships*, the court specifically noted that the two circumstances described in *Allied-Signal* were mere "examples" of the "fact intensive" operational function test. 961 P.2d at 413. And although the court found that the income at issue was not apportionable pursuant to that test, the court remanded for a determination on the applicability of the unitary business test. See *id.* at 414. As for *Pennzoil*, the court there found that the disputed income was apportionable under the *Corn Products* doctrine, see 33 P.3d at 318, which of course is one of the two circumstances *Allied-Signal* expressly anticipated as an example of an operational function. See *supra* p. 42. That the *Pennzoil* court found the operational function test satisfied under these circumstances in no way suggests that the court believed the test should be limited to the examples this Court provided in *Allied-Signal*.

Finally, as for the series of *Hercules* cases, also cited by Mead, see Pet. Br. 47-48, they, too, do not suggest a different result than the Illinois Appellate Court reached here. This is because the holdings in *Hercules* that there existed no unitary or operational relationship were based on factual findings that the taxpayer either could not or did not control the asset at issue. See *Hercules Inc. v. Comptroller of Treasury*, 716 A.2d 276, 281 (Md. 1998); *Hercules Inc. v. Comm'r of Revenue*, 575 N.W.2d 111, 116-17 (Minn. 1998); see also *Hercules, Inc. v. Dep't of Revenue*, 753 N.E.2d 418,

426 (Ill. App. Ct. 2001). Here, by contrast, Mead exercised its control over Lexis/Nexis in myriad ways.[15]

And, in any event, the *Hercules* trio has been criticized as "taking too narrow a view of the 'operational function' concept." *State Taxation*, at S8-7. Thus, the academic scholarship recognizes that correct application of *Allied-Signal* dictates that any gain realized from the sale of a subsidiary, over which the taxpayer had considerable control and with which it dealt regularly, should be constitutionally apportionable. See *id.*

[15] Mead contends that the Department's motion to publish the unpublished order originally issued by the Illinois Appellate Court in the present case is a concession that the order departed from the law set forth in *Hercules*. See Pet. Br. 37 n.10. To the contrary, the motion distinguished the facts of this case from the facts of *Hercules*, Pet. App. 44a-45a, and argued that, as a result of these factual distinctions, the court's order "explain[ed] an existing rule of law," *id.* at 43a, thus making the order suitable for publication under Ill. Sup. Ct. R. 23(a)(1).

CONCLUSION

The judgment of the Appellate Court of Illinois should be affirmed.

Respectfully submitted,

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